Mary Cottrell, Secretary October 1, 2004
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, MA 02110

RE: Boston Gas Company d/b/a KeySpan Energy Delivery New England, D.T.E. 04-9

Dear Secretary Cottrell:

On February 3, 2004 the Boston Gas Company, Colonial Gas Company and the Essex Gas Company, d/b/a KeySpan Energy Delivery New England ("Company" or "Keyspan") filed a Gas Resource Portfolio Management and Gas Sales Agreement with Entergy-Koch Trading, L.P. ("Entergy-Koch") for approval by the Department of Telecommunications and Energy ("Department"). KeySpan filed this agreement in response to an order by the Department in the Company's last rate case. *Boston Gas Company*, D.T.E. 03-40, p. 225 (2003). Pursuant to the procedural schedule established by the hearing officer, the Attorney General submits this letter as his initial brief.

The Department has witnessed a steady evolution of the administration of gas portfolios from the asset management arrangement, *Gas Unbundling*, D.T.E. 98-32-B, p. 57 (1999) (fixed fee to utility for use of assets), to the use of optimization agreements encompassing a wide range of trading activities, *Berkshire Gas Company*, D.T.E. 01-41 (2001) (optimization contract with guaranteed minimum payments with possibility of additional shared savings), to the current pending request for the approval of an optimization agreement permitting derivative transactions and margin sharing on optimized savings. Exh. KeySpan-2, p. 5; September 2, 2004, hearing transcript (Trans.), pp. 13-16, 70-71). To ensure that Massachusetts customers are protected in this evolving market area, the Department should standard of review should incorporate a specific prudence requirement for ongoing utility behavior under these agreements.[1] The growing complexity of the activities possible under optimization contracts and the potential for the unmonitored use of utility assets by traders who might not take into account the best interests of Massachusetts customers necessitates this change. The Department should not permit a utility to delegate to third party portfolio managers activities the Department would otherwise prohibit

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[1] Although Department precedent would not support the converse proposition, that a utility need not be prudent in the management of its contracts, a specific requirement here would protect Massachusetts consumers in this complex and evolving area.

if the utility engaged in them directly.[2]

The Department traditionally uses the public interest standard to evaluate both gas supply contracts, *Gas Unbundling*, D.T.E. 98-32-B, p. 57, and portfolio optimization agreements. *Berkshire Gas Company,* D.T.E. 01-41, p. 9. To determine whether the proposed acquisition of a resource is consistent with the public interest, the Department evaluates whether, at the time of the acquisition or contract renegotiation, the transaction (1) was consistent with the company's portfolio objectives, and (2) compared favorably to the range of alternatives reasonably available to the company and its customers, including releasing capacity to customers migrating to transportation. *Id*. This standard does not address the utility's ongoing behavior under an approved contract, which a prudence test could address. *See e.g., Boston Edison Company v. Department of Public Utilities*, 393 Mass. 244, 245 (1984) (prudence under G. L. c.164, § 94G(a), determined in light of the facts the company knew or should reasonably have known at the time of the actions in question); *Boston Gas Company*, D.P.U. 93-60, pp. 24-25 (1993). In the context of base rates, costs must be prudently incurred to be recovered from customers. *Town of Hingham v. Department of Telecommunications & Energy*, 433 Mass. 198, 202 (2001). Adapting this standard to portfolio optimizations agreements, a utility should not be permitted to pass along the costs of portfolio activities to its Massachusetts customers unless the company has been prudent in its oversight of the portfolio management.

For example, a portfolio optimization partner, as a third party trader for other entities as well for a utility, has the market knowledge and discretion to structure trades among numerous parties, including other utilities, unregulated utility affiliates and other private investors . Once the optimization partner has achieved the guaranteed minimum payment levels required by the optimization agreement with a company, it has no incentive to continue to use company assets for the benefit Massachusetts customers. Any benefits from the company's assets above the guaranteed minimum levels could be used as a "hedge" to offset losses from activities for other entities. In order to deter this behavior, a utility must require the asset manager to provide contemporaneous documentation of all trading related activity, including access to the book, and monthly reports of settled and open transactions. The portfolio activities should then be subject to independent outside audit which would determine whether these activities were in the best interests of its Massachusetts customers. Although a margin sharing arrangement like the one proposed by the Company may provide some incentives for KeySpan to monitor its asset manager since the Company would stand to benefit if customers benefit, the Department should impose the same documentation and audit requirements to ensure the integrity and accountability of portfolio activities if it approves margin sharing under these circumstances.[3]

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[2] A company's responsibilities to take all prudent actions to ensure reasonable costs are "nondelegable statutory obligations." *Commonwealth Electric Company v. Department of Public Utilities*, 397 Mass. 361, 366 n. 2 (1986).

[3] The Attorney General's opposition to margin sharing has been more fully explained in the briefs in D.T.E. 04-47, the pending request of the Berkshire Gas Company for approval of an optimization agreement.

In this case, KeySpan has refused to receive the written monthly transaction reports it is required to receive from Entergy-Koch under the proposed optimization agreement, Trans., pp. 32-35, does not otherwise receive any correspondence from Entergy-Koch describing ongoing activities under the contract, Trans. pp. 44-45, and does not maintain any internal written reports evaluating Entergy-Koch's contract performance. Trans., p. 45. The Company thus deliberately remains unaware and uninformed of the activities Entergy-Koch undertakes with the Company's assets. The failure to require contemporaneous documentation of portfolio activities and to otherwise monitor trading will greatly reduce the effectiveness of any outside audit that the Company may later conduct. Trans. pp. 46-48 (Entergy-Koch in control of all documentation that may be subject to an audit). Such oversight is not prudent and the Department should hold the Company responsible for portfolio activities against the best interests of Massachusetts customers.

In conclusion, the Department should adopt the recommendations made by the Attorney General as in the best interests of consumers.

Respectfully submitted,

Alexander J. Cochis
Assistant Attorney General

cc: Service list